Trade barriers

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Definition

A basic definition of trade barriers could be 'all factors that influence the amount of goods and services shipped across international borders' (Feenstra and Taylor, 2017a). This definition is quite neutral, and it needs to be understood that the word 'barrier' has a negative connotation, which means that a trade barrier would be any instrument that limits or restrict trade between countries, as opposed to free trade. It is generally accepted that free trade is good for productivity and economic growth, but it is also true that most countries apply some sort of trade restriction, for different reasons.

Trade barriers and Development

1. Introduction

Since the end of World War II and up to very recently, the world has experienced high levels of trade liberalisation, which is defined as 'a move towards freer trade through the reduction of tariff and other barriers' (Lee, 2005). Also up to recent times, it has been widely recognised that trade liberalisation can stimulate economic growth, job creation and higher wages (OECD, 2011), and as such lead to improved living standards (Mercurio, 2013). Much of this generalised perception is grounded on the efforts of the General Agreement on Tariffs and Trade (GATT), now World Trade Organisation (WTO), to reduce conventional tariff barriers (Ederington and Ruta, 2016). As a result of this progress in the reduction of tariff barriers, the focus in recent times has been put in the so called non-tariff barriers (Duran-Lima et al., 2010; Fugazza, 2013; Koczan and Plekhanov, 2013), which seem to be gaining importance.

While there have always been different levels of trade liberalisation in different countries, and as such countries 'more open to trade' or 'more autarkic', recent events seem to indicate a movement towards the reduction of international trade and the adoption of more protectionist policies. The economic crisis of 2007-2008 saw attempts in some countries to introduce protectionist approaches, but the reaction of the G20 averted this (OECD, ILO, World Bank and WTO, 2010). However, restricting trade measures were estimated to have negative impacts on growth and employment: $2.16 drop in world exports and $0.73 drop in world income, per each dollar increase in tariff revenues (OECD, 2010).

More recently, the election of Donald Trump in the US and his 'America First' policy, has seen how tariffs have been imposed on steel and aluminium, beginning was is already considered a 'trade war' (Ljunggren and Rampton, 2018). At the same time, the Brexit negotiations for the withdrawal of the UK from the EU have trade as one of the most conflicting topics, with generalised concerns about the negative effects that a lack of access to the EU market and the imposition of tariffs can have for different economic sectors, particularly for the British side (Centre for European Reform [CER], 2016; Emmerson, Johnson and Mitchell, 2016). This is a reflection of another phenomenon observed since the 1950s but quite generalised nowadays, which is the creation of free trade areas and the signature of free trade agreements by groups of countries. The EU (European Union) is considered the most important one (European Commission, 2012 and 2018) but we also have NAFTA (North America Free Trade Agreement), between the US, Canada and Mexico, that Mr. Trump is putting in jeopardy (Amadeo, 2018), Mercosur (Stratfor Worldview, 2018) or ASEAN (Chaitrong, 2018). More recently, international agreements are not limited to trade but also investment, such as CETA (Hübner et al. 2017) or TTIP (Kraatz, 2014).

So two main trends can be observed with regard to trade and trade barriers worldwide. On one side, the conflict between those who advocate for protectionism and those who defend free trade in free markets. Part of this conflict, also linked to the surge of populist political movements in different countries, finds its origin in some negative consequences of the trade liberalisation and the subsequent globalisation process that the world has witnessed in recent decades: While there have been significant gains in growth, employment and income as a result of trade, those benefits have not reached everyone, with less competitive sectors experiencing job losses and the accompanying negative social effects. It is for this reason that those who advocate for free trade also recognise that the removal of trade barriers needs to be complemented by specific support policies, at national and international levels, in order to facilitate the adjustment of the negatively affected sectors and the share of trade benefits by all (OECD et al., 2010).

The other trend is the increasing role of the services sector in trade, while traditionally trade and trade agreements used to be focused on goods belonging to the agricultural and manufacturing sectors. Trade barriers can exist for both groups of products (goods and services). The following sections will explore how different trade barriers affect different sectors and the impacts they can have in the potential growth for different countries.

2. Types of trade barriers

2.1. Tariffs

As it has been already mentioned, the main classification of trade barriers distinguishes between tariff and non-tariff barriers, with the former being the most widely known. But within tariff barriers there are many classifications to be made. However, before going into any classification or typology, we need to understand what a tariff is. In this regard, a tariff can be defined as ‘a tax levied on a product when it crosses national boundaries’ (Carbaugh, 2017).

‘Import tariffs’ are the most widespread type, and are levied on an imported product, as opposed to the less common ‘export tariffs’, often used by developing countries (Carbaugh, 2017). Looking at the reasons why a tariff is levied, we find a further distinction between ‘revenue tariffs’ and ‘protective tariffs’. As the names indicate, revenue tariffs are imposed as a source of government revenue, and historically this was the main reason for tariffs to be issued. Nowadays, however, and particularly amongst industrialised countries, tariffs are imposed to raise the price of imports, to protect domestic industries that would be at a competitive disadvantage under free trade conditions (Kreinin, 2006). In reality, most tariffs will have a bit of both reasons (ie. revenue raising and industry protection), though an extreme case can exist, called ‘prohibitive tariff’, a tax high enough to keep out all the imports, with protection as its only purpose and no revenue generated (Kreinin, 2006).

A general classification of tariffs according to the way they are issued distinguishes between: 'Specific', being 'a fixed amount of money per physical unit of the imported product'; 'Ad valorem', established as 'a fixed percentage of the value of the imported product'; or 'compound tariff', which would be a mix of the other two (Carbaugh, 2017). A more detailed classification under the same approach (WITS, 2010) lists the types of non-ad valorem tariffs as:

- Specific tariffs (defined above)
- Mixed tariffs: Expressed as specific or ad valorem rate 'depending on which one generates the most revenue' (WITS, 2010)
- Compound tariffs (defined above)
- Tariff rate quotas: 'Made up of a low tariff rate on an initial increment of imports, within quota quantity, and a very high tariff rate on imports entering above that initial amount' (WITS, 2010).

It is debatable, however, if the last term can be considered a tariff or a quota, as it will be explained below.

2.2. Quotas

Amongst the non-tariff barriers, and linked to the classification shown above, the instrument most commonly used are 'import quotas'. Import quotas 'are a restriction on the amount of a particular good that one country can purchase from another country' (Feenstra and Taylor, 2017b).

The theory of international trade argues that tariffs and quotas are basically equivalent or have the same effects, but this needs to be punctuated as said effects are dependent on many circumstances. With a tariff it is the government who collects the revenue, and the effects on welfare will depend on how that revenue is used or redistributed. With a quota, who benefits will depend on how the policy is implemented. If the government auctions the licenses to import and allocate them to the highest bidder, it will be the government who will receive a benefit equivalent to the tariff (Caves et al. 2007). But if the government gives away the licenses for free to domestic importers, they will be the ones ripping the benefits. On the other hand, the government could decide to award the licenses to foreign exporters, in which case their country would gain the rent (Caves et al. 2007).

Differences between tariffs and quotas' effects on welfare have also been explored by academic literature. It is argued that when countries undergo regional integration creating customs unions, the existence of tariffs or quotas will require different trade policy adjustments, and if we are in the presence of imperfect competition, the benefits of the custom union could disappear (Hansen and Sala, 2013). The existence of asymmetric information also undermines the equivalence of tariffs and quotas, and has an impact on how 'governments, firms and consumers rank different trade policy instruments' (Matschke, 2003). Under monopolistic competition, research indicates (Jørgensen and Schröder, 2003) that an ad valorem tariff will result in the same welfare level as an initial sold quota, while welfare would increase compared to a shared quota. Bloningen et al. (2012) also find differences between tariffs and quotas insofar quotas would increase market power for domestic producers whereas tariffs, not affecting directly prices nor quantities, would not influence market power.

In addition to these differences, and similarly to the case of tariffs, there is wide variation in the classification or typology of quotas. The ones mentioned so far are considered 'absolute quotas' (Carbaugh, 2017), usually in place for a specific time period, and with the general effect of limiting imports below the level that would occur under free trade. These quotas can also be 'global quotas', when the number of goods is limited but without specifying from where or whom; or 'selective quotas', where the quota is allocated to specific countries (Carbaugh, 2017).

Tariff-rate quotas would also be included here, presenting characteristics of both tariffs and quotas. The main difference with an absolute quota would be that imports could exceed the amount specified by the quota, but the excess would be subjected to a high tariff. An example of the use of this instrument can be found for the imports of sugar in the US (Carbaugh, 2017).

Less common and to some extent less visible than import quotas are 'export quotas' (Feenstra and Taylor, 2017b), with the aim to limit the amount that companies are allowed to export. The most well-known example of export quotas is the system used by the OPEC (Organisation of Petroleum Exporting Countries), in an attempt to keep oil prices high. The OPEC constitutes an international cartel, and contrary to other instruments, it is an agreement between suppliers (business organisations) and does not include consumer countries (Kreinin, 2006). However latest developments in energy markets and the international commitments towards decarbonisation put the goals of the OPEC in jeopardy (Fernandez, 2018).

2.3.Other trade barriers

Together with quotas, and partly because import quotas are not allowed under WTO rules, countries may use other quantitative restrictions instruments, namely 'Voluntary Export Restraints' (VERs). In this case the importing country induces the exporting country to limit their shipments (Caves et al. 2007). Countries reach a bilateral agreement, usually pressured by import-competing industries, in order to reduce said competition. The exporter countries are 'forced' to accept these restrictions to avoid further actions from the importer countries, and as there has been an agreement, there is supposedly no threat of retaliation (Kreinin, 2006). The idea is that VERs will benefit the exporting country but evidence seems to indicate that this effect is only temporary, under perfect competition on the goods market, or if the exporting country is bigger than the importing country (Wang, 2011).

For certain raw materials or agricultural products (primary commodities), countries can also establish 'International Commodity Agreements' (ICAs), with the purpose of stabilising the world price of the commodity or dispose of surpluses (Gilbert, 2011). ICAs involve both producer and consumer countries, as opposed to cartels, and can take three main forms (Kreining, 2006): Export restriction schemes, under which we could find the VERs previously mentioned; Buffer stocks, with the purpose to maintain the price of the commodity within certain range, buying or selling the commodity from central stocks; and multilateral contracts, which 'specify a maximum price at which producing countries are obliged to sell stipulated quantities to consuming countries and a minimum price at which consuming countries are obliged to purchase stipulated quantities from producing countries' (Kreinin, 2006).
Presented as an example of ICA (Kreinin, 2006), as an import quota (Carbaugh, 2017; Feenstra and Taylor, 2017b) or as a combination of quantitative restrictions and tariffs (Caves et al. 2007), we find the Multfibre Arrangement (MFA). It was negotiated in the seventies and was

in place until 2005, regulating the trade in textiles and apparel, to restrict the imports of said products mainly in Canada, the US and the EU. Once the system was abolished, an increase in the trade of textiles and clothing has been observed, bigger in the case of the latter. The average price of both clothing and textiles has decreased, and the average quality of the clothing exported has also fallen (Whalley and Yao, 2016). This is an indicator that not all the effects of a trade restriction instrument are going to be negative.

Other instruments currently used to protect domestic production fall under the category of 'domestic' or 'local' content requirements. This is a direct regulation to prevent the practise of outsourcing or production sharing, with the specific aim to protect domestic levels of employment. It involves that a minimum fraction of a final good has to be produced domestically (Kreinin, 2006) if the product is to qualify for zero tariff rates (Carbaugh, 2017). Evidence seems to indicate that the use of these instruments has increased in recent years, despite the negative effects observed for long-term competitiveness (OECD, 2016). In a similar manner, but with the stated purpose of favouring environmental-friendly behaviours, eco-labelling is being increasingly used by developed countries, with estimated negative consequences for market competition from developing countries (Verbruggen et al. 1995; Naumann, 2001) and with potential to originate trade disputes (Center for International Environmental Law, 2005).

It would be impossible to explore all the existing measures that governments can apply to protect domestic industries and as such become restrictions to trade. Apart from the ones already mentioned, it is worth also noting the role of export subsidies (Feenstra and Taylor, 2017b) and border tax adjustments (Kreinin, 2006). The former consist on payments for every unit exporter (fixed amount or a percentage of the sales price) with the aim to increase production in particular industries. The WTO target was to abolish them by 2013, but that target has not been achieved (Feenstra and Taylor, 2017a). The latter refers to adjustments on the border, basically export rebates and import fees, to level the 'playing field' for countries that do not levy certain taxes (Kreinin, 2006).

Last but not least, it is necessary to mention dumping practices and the corresponding antidumping policies. Dumping is considered a form of international price discrimination, and can be sporadic, when a company attempts to dispose of excess inventory by selling in foreign markets at a price lower than in the domestic market; or predatory, when the purpose of the price reduction abroad is to drive foreign producers out of business (Carbaugh, 2017). Under WTO rules, countries are entitled to apply tariffs (antidumping duties) if they detect a dumping practice for a particular product (Feenstra and Taylor, 2017a) and it is not unusual to see such measures being approved.

The following section will discuss the consequences that the implementation of trade barriers like the ones described here have for welfare and development.

3. Effects of trade and trade barriers on development

It becomes apparent that despite the advantages of free trade, countries have been applying different types of trade barriers (or restrictions) for a long time. So the question is: To which extent are trade barriers a negative thing?

The effects of trade barriers can be analysed through different points of view: One can look at the effects in the country that impose the barrier or the effects in the country or countries that 'suffer' or 'pay' due to the barrier. Overall in many cases we will also find effects in third countries and the world economy, and there will be also differences between the short and the long run.

From a commercial point of view things are relatively clear. If countries do not trade they will be limited to consume only the items that the country produce, and since not every country can produce absolutely everything, in the absence of trade consumption needs will not be fulfilled. So with trade there are at least 'consumption gains' (Carbaugh, 2017). The theories explaining international trade recognise, however, that there are winners and losers with trade, as there will be a redistribution on income, which means that there will be groups who will actually lose income (Schor, 2016). If a country decides to implement a trade barrier in order to prevent that loss of income, usually for a less competitive domestic industry, new redistributions of income will occur.

If as a result of an instrument such as a quota or a VER the domestic country is receiving less products from abroad, the first effect is that consumers will have less choice of products, so there will be consumption loses. If the instrument used is a tariff, the price of the foreign product will be increased by the tariff, so again consumers will lose as they will have to pay higher prices for those products, their demand will be reduced, giving room to domestic producers to sell their production (Kreinin, 2006). So income is redistributed from consumers to producers, and depending on the instruments, also to the government, who would collect the tariff or the quota rent, depending on the allocation system. There has also been a redistribution of income from foreign producers to domestic producers (Feenstra and Taylor, 2017b). Overall the trade barrier will generate a welfare loss, called 'deadweight loss' (Carbaugh, 2017), which will be worse if the country imposing the barrier is not big enough to affect world prices.

The empirical evidence on the negative effects of trade barriers has been building overtime. Haveman and Thursby (2000) argue that the effects of barriers change considerably depending on the timeframe considered, the stage of development the country is, and the type of commodity the barrier is imposed upon. For agricultural commodities they found evidence of a reduction of the levels of trade due to the barriers, a concentration of the source of imports into the largest importers, and a shift in trade patterns amongst exporters (Haveman and Thursby, 2000). On the contrary, trade openness is found to have positive effects on economic growth both in the short and the long run, with a positive relationship also with capital formation (ie. investment) (Keho, 2017). Non-tariff barriers have been studied recently, with the conclusion that for instance, sanitary and phytosanitary standards reduce the value of trade in some commodities, acting as a substitute for import tariffs (Hwang and Lim, 2017). Local content requirements have been found to reduce the competitiveness of the imposing country as a whole, not only the targeted sector, undermining opportunities for innovation and diversification, and as such, for economic growth (OECD, 2016).

How is all this related to development? Though there are examples of trade barriers used by both developed and developing countries, it is often argued that trade protection from developed countries denies access to critical markets to developing countries, hindering their attempts to grow (Carbaugh, 2017). The literature has provided some evidence of this occurrence, such as the protection in the Netherlands for cut flowers (Verbruggen et al. 1995), the Multifibre Agreements mentioned in the previous section, or sanitary and phytosanitary measures for agricultural exports in general (Henson and Loader, 2001).

At the same time, theories of development argue that due to the differences in capital, technology, skilled labour, and related factors, it may be preferable that developing countries do not open to international trade in a sudden way, and specific trade policies need to be considered (Thirlwall and Pacheco-Lopez, 2017). In this regard, there are several arguments used in favour of the implementation of trade barriers or trade protection (Thirlwall and Pacheco-Lopez, 2017), which could also be used by developed countries:

- The infant industry argument: When a country wants to start developing a new sector, competition from abroad may limit the opportunities of success, so protection is required until the industry reaches an optimum size in terms of costs of production.
- Existence of external economies of production: In case social costs of production are lower than the private costs.
- Distortions in the labour market: When international trade can cause loss of employment in particular sector with particularly negative social consequences.

There are also non-economic arguments used in favour of particular trade policies that become restrictive (Caves et al. 2007): One is related to what is called the 'voting model'. In this case, citizens would be allowed to choose which policy they think is most adequate in order to maximise social welfare, so it may be the case that they could vote for the imposition of a tariff in they perceive it redistributes income from capital to labour. Another argument (also following Caves et a. 2007), is that of pressure received from lobbying groups, which makes sense and has been previously hinted when talking about domestic industries competing with imports. If said industries have lobby power they can exert pressure for barriers to be implemented, even if the welfare of the society as a whole may worsen. A third argument is that of the 'conservative social welfare function', which revolves around the idea that the government's job is to make people perceive that they are treated fairly and do 'not suffer unreasonably from economic misfortunes'. This is connected with the argument of possible social problems due to loss of employment.

In sum, there are arguments in favour and against trade barriers that countries need to consider if their final goal is to improve levels of development and economic growth. A careful consideration also needs to be given to the fact that most of the arguments in favour of free trade, from the economic theory point of view, are based on assumptions and models that are not realistic (Schor, 2016), and as such need adjustments to the particular circumstances and stages of development of the concerned countries.

Conclusions: What way forward?

The world is living in a period of uncertainty about the role of trade and the globalisation process in general. Despite the many advantages of free trade, countries have always been applying different types of trade barriers to protect their domestic industries for different reasons. There has been an evolution though, on the use of said barriers, with a decrease in the use of tariffs and a generalised increase in the use of non-tariff barriers. This has been promoted in the context of the WTO as an institution overseeing the rules of international trade for many decades.

But things are changing. Between the attacks of Donald Trump to the WTO, threatening to pull the US out (Micklethwait et al. 2018), and the impossibility to reach agreements and achieve any meaningful progress in negotiation rounds (Sachdeva, 2017), countries are resorting more and more to bilateral trade negotiations and regional trade agreements, leaving aside this institutional forum and posing doubts about its future role. The fact that the WTO approach goes generally against the type of trade barriers that developing countries are pushing for in order to get more balanced access to international trade markets (Schor, 2016) does not speak favourably to its cause. There is a persistent divide between developing and developed countries with regard to the focus of trade negotiations, with the former wanting to deal with legacy issues and inequalities coming from previous talks, and developed countries wanting to move towards talks about e-commerce, investment facilitation and other new issues (Sachdeva, 2017).

Trade barriers have numerous negative consequences, but in the context of development, it may be the case that their use can bring some positive results. The framework of the Sustainable Development Goals(SDGs) for 2030 acknowledges that the policies that affect trade flows will have an important role to play in the implementation of said SDGs, particularly with regard to poverty alleviation, food security, natural resources and clean energy (Bellmann and Tipping, 2015). What is more, it has been argued that non-tariff barriers can contribute to the Sustainable Development Agenda, if they become a source of regional or international collaboration, and promote convergence of regulations that reduce 'regulatory distance' (Shirotori, 2016).

So it is a case of wait and see, and what will be the final direction that current debates about the role of international institutions have on trade take, as well as, how countries will manage to collaborate to solve their differences.

Cross References

World Trade Organisation, Foreign investments in least developed countries, Foreign Direct Investment, fair trade, trade with less developed countries

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